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Summary of the Economic and Social Survey of Asia and the Pacific 2008

Summary

According to the *Economic and Social Survey of Asia and the Pacific 2008*, developing economies in the Asia-Pacific region, having enjoyed their fastest growth in a decade, are expected to see it moderate to 7.7 per cent in 2008, a slight reduction from the growth rate of 8.2 per cent in 2007. The main short-term challenge to economic prospects comes from the still unravelling sub-prime credit crisis in the United States of America and its impact on the world economy. The survey emphasizes that the region's solid macroeconomic fundamentals, painstakingly put in place and strengthened through the years, have prepared the countries of Asia and the Pacific to absorb and adapt to such external shocks.

Despite good economic performance and the efforts of Governments to foster inclusive development, there are, however, a number of emerging problems in the region. Over 600 million of the world's poor still live in Asia, nearly two thirds of the global total, mainly in rural areas. Other statistics are equally staggering. As many as 97 million children remain underweight, and 4 million children die before reaching age 5. While the region is well prepared to ride out the current turbulence in the global economy, smaller economic shocks can severely affect those most vulnerable in the population. The long-term impact of those shocks, specifically in terms of poverty, unemployment and inequality, is of great concern, and raises a renewed call for the sharing of prosperity and the fruits of high growth and for the placement of sound socio-economic policies at the top of the region's agenda.

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In that spirit, the 2008 survey takes a closer look at agriculture, which is seen as a critical determining factor in poverty reduction and rural development activities. The agricultural sector, which still provides jobs for 60 per cent of the working population in the Asia and Pacific region, sheltering the majority of the poor, has been neglected, and its capacity to lower poverty and reduce inequality has been undermined. Long-term development issues confronting agriculture need to be addressed head on. The survey argues that increasing agricultural productivity in the region can have a profound impact on reducing poverty and proposes a two-track strategy to ensure that agriculture is both economically and socially viable.

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I. Introduction

1. The *Economic and Social Survey of Asia and the Pacific 2008* examines the region's key short- and medium-term prospects and challenges in macroeconomic and selected social areas, especially from the point of view of minimizing human suffering, whether as a result of economic hardship or social instability. The survey also explores critical long-term development issues relevant to all developing countries in the region. In that context, the 2008 survey takes a closer look at agriculture, seen as a critical determinant in poverty reduction and rural development efforts. The publication emphasizes the need to address directly the neglect of agriculture, which still provides jobs for 60 per cent of the working population in the Asia and Pacific region and shelters the majority of the poor, and demonstrates that by increasing agricultural productivity the region can make a significant dent in poverty. The survey proposes a two-track strategy to ensure that agriculture is economically and socially viable and to facilitate migration from the agricultural sector by providing the poor with other skills.

II. Growth to moderate in 2008 but remain robust

2. Developing economies in the Asia-Pacific region, having enjoyed their fastest growth in a decade, are expected to see it moderate to 7.7 per cent in 2008, down slightly from 8.2 per cent in 2007 (see table, and figure I). Developed economies in the region are expected to grow by 1.6 per cent in 2008, slipping from 2 per cent in 2007. The decline in performance is the result of the economic slowdown in the United States of America driven by the end of the housing bubble, the unfolding credit crunch besetting the United States and Europe and the appreciation of many Asia and Pacific currencies against the United States dollar. The economies of China and India, the engines of regional growth, are expected to expand at a brisk pace in 2008, boosting the rest of the region. Commodity- and energy-exporting countries, in particular the Russian Federation, are expected to contribute to the region's strength.

3. Exports may suffer from slower growth in the industrialized countries, but strong domestic demand, driven by consumption in fast-growing countries and by fiscal accommodation, should cushion the blow. In export-dependent economies in East and South-East Asia, exports will have a reduced effect on overall growth, but businesses in China will continue to offer economic opportunities. There will also be an increase in domestic demand, both in consumption and investment.

4. North and Central Asia will continue to benefit from a growth in consumption and construction, thanks to high energy prices. Countries in South and South-West Asia, with domestic economies that are traditionally demand driven, will continue to benefit from strong private consumption and investment and from expansionary fiscal policy. Fiji and Tonga are expected to recover from economic contractions in 2007, the result of political unrest, while in Papua New Guinea there will be a rise in consumption as the benefits of high commodity prices spill over to the rest of the economy.

Table
Selected economies of the Economic and Social Commission for Asia and the Pacific region: rates of economic growth and inflation, 2006-2008
(Percentage)

	Real gross domestic product			*Inflation*[a]		
	2006	*2007*[b]	*2008*[c]	*2006*	*2007*[b]	*2008*[c]
Developing economies of the ESCAP region[d]	8.1	8.2	7.7	4.4	5.1	4.6
East and North-East Asia	8.7	9.0	8.4	1.6	3.8	3.3
China	11.1	11.4	10.7	1.5	4.8	3.5
Hong Kong, China	6.8	6.1	5.7	2.0	1.8	3.4
Mongolia	8.4	9.0	8.0	5.1	9.0	..
Republic of Korea	5.0	5.0	4.9	2.2	2.6	3.1
Taiwan Province of China	4.7	5.5	4.7	0.6	1.8	2.4
North and Central Asia	7.6	8.6	7.1	9.7	9.4	8.2
Armenia	13.3	13.8	9.0	2.9	4.4	4.0
Azerbaijan	34.5	25.0	25.0	8.3	16.7	16.0
Georgia	9.4	11.0	9.0	9.2	9.2	8.0
Kazakhstan	10.6	9.0	9.0	8.6	10.8	8.0
Kyrgyzstan	2.7	8.2	7.0	5.6	10.2	5.0
Russian Federation	6.7	8.1	6.5	9.7	9.0	8.0
Tajikistan	7.0	7.8	6.5	11.9	21.5	10.0
Turkmenistan	9.0	10.0	10.0	8.2	6.5	9.0
Uzbekistan	7.3	9.0	7.0	14.2	12.2	9.8
Pacific island economies	3.1	2.7	4.8	2.8	2.8	3.1
Cook Islands	0.8	2.5	3.5	3.4	2.8	2.0
Fiji	3.6	-3.9	2.2	2.5	4.1	3.0
Papua New Guinea	2.6	6.2	6.6	2.3	1.8	2.9
Samoa	1.8	3.0	3.5	3.3	4.4	4.1
Solomon Islands	6.1	5.4	4.2	8.1	6.3	7.3
Tonga	1.3	-3.5	0.8	7.0	5.9	5.0
Vanuatu	5.5	4.7	4.6	2.6	2.5	2.5
South and South-West Asia[e]	8.0	7.4	7.4	8.3	7.9	7.0
Bangladesh	6.7	6.5	6.5	7.2	7.2	6.5
India	9.6	9.0	9.0	6.7	5.5	5.0
Iran (Islamic Republic of)	6.2	5.8	5.0	13.6	17.0	16.0
Nepal	2.8	2.5	4.0	8.0	6.4	6.0
Pakistan	6.6	7.0	6.5	7.9	7.8	7.5
Sri Lanka	7.7	6.7	7.0	10.0	15.8	10.0
Turkey	6.1	5.0	5.5	9.6	8.6	6.8

	Real gross domestic product			*Inflation*[a]		
	2006	*2007*[b]	*2008*[c]	*2006*	*2007*[b]	*2008*[c]
South-East Asia	6.0	6.2	5.8	6.7	3.7	4.4
Cambodia	10.8	8.5	7.0	4.7	3.0	3.0
Indonesia	5.5	6.2	6.2	13.1	6.3	6.4
Lao People's Democratic Republic	8.3	7.4	8.1	6.8	4.0	5.0
Malaysia	5.9	5.7	5.8	3.6	2.0	2.8
Philippines	5.4	7.0	6.7	6.2	2.7	3.5
Singapore	7.9	7.5	4.9	1.0	1.8	3.0
Thailand	5.1	4.5	4.9	4.7	2.3	3.3
Viet Nam	8.2	8.4	8.2	7.7	7.9	7.7
Developed economies of the ESCAP region	2.4	2.0	1.6	0.6	0.2	0.6
Australia	2.7	4.2	3.2	3.5	2.4	3.1
Japan	2.4	1.8	1.4	0.3	0.0	0.4
New Zealand	1.8	3.1	2.3	3.4	2.4	2.6

Sources: Economic and Social Commission for Asia and the Pacific (ESCAP), based on national sources; International Monetary Fund (IMF), *International Financial Statistics*, CD-ROM (Washington, D.C., 2007); Asian Development Bank (ADB), *Key Indicators of Developing Asian and Pacific Countries 2007* (Manila, 2007); Inter-State Statistical Committee of the Commonwealth of Independent States, available from http://www.cisstat.com (accessed 3 December 2007 and 5 February 2008); and ESCAP estimates.

[a] Changes in the consumer price index.

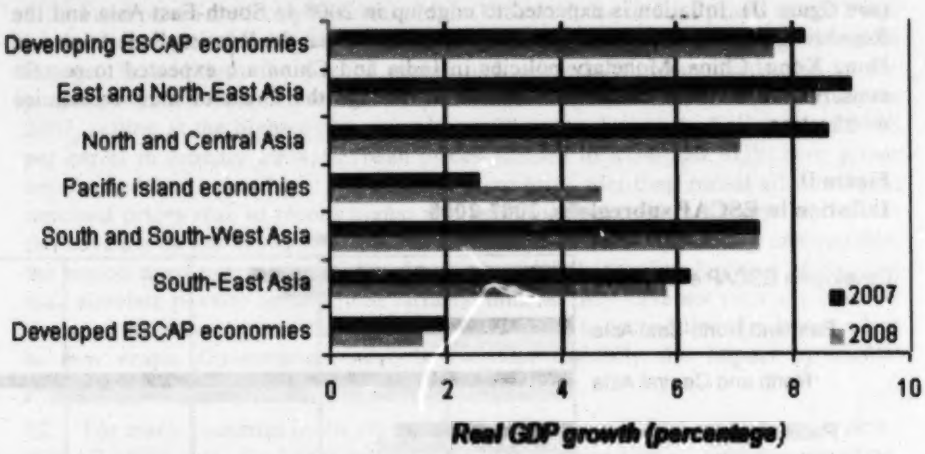
[b] Estimate.

[c] Forecast.

[d] Based on data for 38 (developing) economies representing more than 95 per cent of the population of the region (including the Central Asian republics); gross domestic product (GDP) figures at market prices in United States dollars in 2004 (at 2000 prices) have been used as weights to calculate the regional and subregional growth rates.

[e] Fiscal year 2005/06 is 2005 for India and the Islamic Republic of Iran and 2006 for Bangladesh, Nepal and Pakistan.

Figure I
Rates of economic growth in the ESCAP region, 2007-2008



Sources: ESCAP, based on national sources; IMF, *International Financial Statistics*, CD-ROM (Washington, D.C., 2007); ADB, *Key Indicators of Developing Asian and Pacific Countries 2007* (Manila, 2007); Inter-State Statistical Committee of the Commonwealth of Independent States, available from http://www.cisstat.com (accessed 3 December 2007 and 5 February 2008); and ESCAP estimates.

Note: Figures for 2007 are estimates and those for 2008 are forecasts. There are 38 developing ESCAP economies. Calculations are based on the weighted average of GDP figures at market prices in United States dollars in 2004 (at 2000 prices).

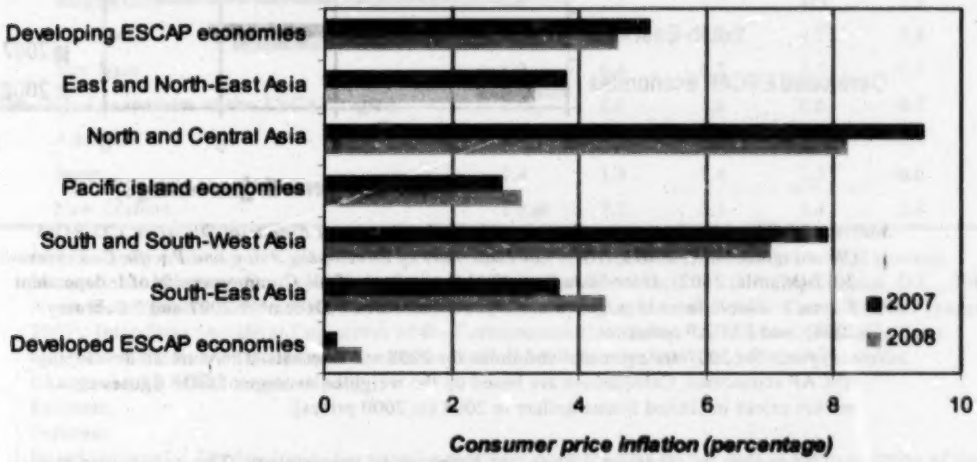
5. The region is entering a phase of heightened uncertainty. The sub-prime credit crisis in the United States is still unravelling, and a significant slowdown of that economy and further turmoil in financial markets cannot be ruled out. In 2007 the Asia-Pacific economies felt the effects of the global financial turmoil, largely through increased volatility in domestic equity markets and a measurable widening of the yield on their external debts, although neither effect was long-lasting. The resilience of the region lies mainly in its healthy macroeconomic base, which has enabled countries to adopt supportive fiscal and monetary policies despite a significant decline in export growth, financial market volatility and inflationary pressures as a result of high oil prices. Large foreign reserves have added to that resilience.

A. Greater uncertainty about inflation

6. Inflation in the developing economies of the ESCAP region was 5.1 per cent in 2007, up from 4.4 per cent in 2006. Currency appreciation in most economies moderated the impact of high international oil and food prices. With the exception of East and North-East Asia, all ESCAP subregions had lower inflation in 2007 than in 2006, and monetary policy has varied accordingly. China, India, the Republic of Korea and Taiwan Province of China tightened their monetary stance in 2007, while Malaysia maintained steady interest rates. In contrast, Indonesia, the Philippines and Thailand eased their interest rates.

7. Inflation for the developing economies of Asia and the Pacific is projected at 4.6 per cent in 2008, with currency appreciation cushioning high oil and food prices (see figure II). Inflation is expected to edge up in 2008 in South-East Asia and the Republic of Korea, but should moderate in China, India, the Russian Federation and Hong Kong, China. Monetary policies in India and China are expected to remain conservative as those countries continue to manage the threat of their economies overheating.

Figure II
Inflation in ESCAP subregions, 2007-2008



Source: ESCAP calculations.

Note: Figures for 2007 are estimates and those for 2008 are forecasts. Inflation rates refer to changes in the consumer price index. There are 38 developing ESCAP economies. Calculations are based on the weighted average of GDP figures at market prices in United States dollars in 2004 (2000 prices).

8. Monetary authorities face a dilemma in 2008. Restrictive policies may be required to counter inflationary pressures, but permissive policies may also be needed in order to manage significant slowdowns in the growth of GDP. Countries with credible monetary policies and lower inflationary expectations should be able to ride out inflation in 2008.

9. The key challenge is to decipher how much of the surge in oil and food prices in 2007 might continue in 2008 and beyond. The price of Brent crude oil hovered at $70 a barrel for most of 2007, approaching $100 in November, and reaching that price in January 2008. A weakening United States dollar and geopolitical tensions close to major oil-producing areas have been, and will continue to be, factors outweighing those of demand in determining price movements.

10. Pressure on oil prices may ease as the industrial economies, led by the United States, slow down. Recent increases in the price of oil also reflect speculation. There is reason to believe that supplies may grow, especially as new fossil fuels become viable, investments in remote areas and deeper waters pay off and oil sands, heavy crude and coal-to-oil conversions are developed.

B. Food inflation: the next big challenge

11. Food prices are likely to remain high. The rapid rise in food prices in 2007 was partly the result of drought in Australia, flooding in China and dry weather in Europe. In addition, the use of grains and oilseeds, the key feedstuffs in the production of biofuels, led to a marked increase in agricultural commodity prices in 2007, selling at the highest prices in almost 30 years. The cost of oil reached $100 per barrel in January 2008; soybean prices jumped to a 34-year high; corn prices approached an 11-year high; wheat prices were just under their recent all-time high; rapeseed prices rose to record highs; and palm oil futures hit a historic high. With the advance of the movement towards the use of biofuels apparently unstoppable, the region must prepare for higher food prices. While the development of biofuels may alleviate poverty among rural farmers, thus far they have not seen any benefits since, at the present time, they lack the wherewithal to extend their lands and adapt to new crops. Governments need to consider carefully the impact of biofuel production on the poor.

12. For many countries in the region, food prices are a bigger inflationary concern than oil prices since food accounts for a far higher proportion of consumer spending. For example, in the Philippines, food accounts for 50 per cent of the consumer price index (CPI), with energy accounting for only 7 per cent; in India, food represents 46 per cent of CPI; in Indonesia 42 per cent; and in China 33 per cent. Because higher prices for food affect low-income households so severely, Governments may need to consider providing subsidies for the poor in the form of food stamps or cash.

C. Currency appreciation to continue

13. The currencies of countries in the region have appreciated dramatically over the last two years on a tide of huge global liquidity. Since 2006, all major currencies in the region have risen against the dollar. The trend is expected to continue in 2008, in view of the large United States imbalances vis-à-vis the rest of the world and the turmoil in the global financial markets. Between 2006 and November 2007, the won, the currency of the Republic of Korea, rose 7.3 per cent against the dollar, and the Thai baht rose about 17 per cent during the same period of time. However, currencies have not appreciated solely against the dollar; many have also risen against the Japanese yen. The appreciation of currencies against the Chinese yuan is of particular relevance as China competes in third-country markets with other economies of the region.

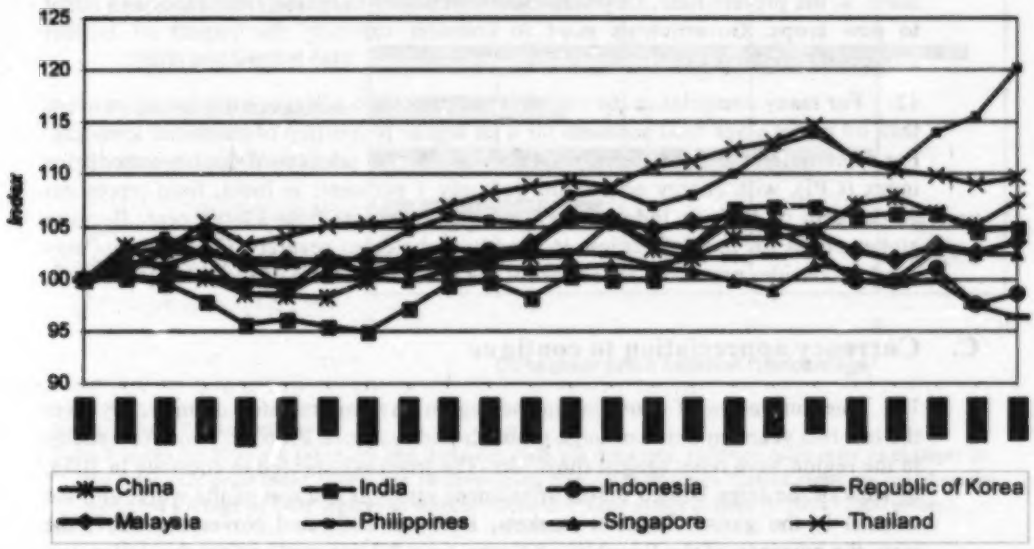
14. The relentless currency appreciation sheltered the region's economies from high oil and food prices, but dealt a blow to the competitiveness of exports. Movements in real effective exchange rates, the best measure for gauging competitiveness, show that all large economies, except those of Indonesia and the Republic of Korea, have experienced appreciation of their currencies since 2006 (see figure III), ranging from 2.4 per cent for Singapore to 20 per cent for the Philippines. Countries of the region have therefore lost export competitiveness not only to the United States but also to other trading partners.

15. Countries experiencing the greatest appreciation in terms of real effective exchange rates since 2006, in particular Thailand and the Philippines, have already seen an impact on their export earnings. Thailand's export growth in dollar terms

fell in the fourth quarter of 2007 (11.6 per cent over the previous year) after rising in the third quarter (11.6 per cent). Export growth in the Philippines became negative in November 2007 (2 per cent year on year), after a rise of 10.5 per cent the previous month.

16. The impact has been greatest in the low technology-intensive manufacturing sector and in other sectors with low import rates, such as agriculture and commodities. In Thailand, local currency export earnings for garments, jewellery, furniture and rubber have been flat since 2006. In the Philippines, textiles, furniture, bananas and pineapples have been most heavily affected.

Figure III
Real effective exchange rates for selected ESCAP economies, 2006-2007[a]



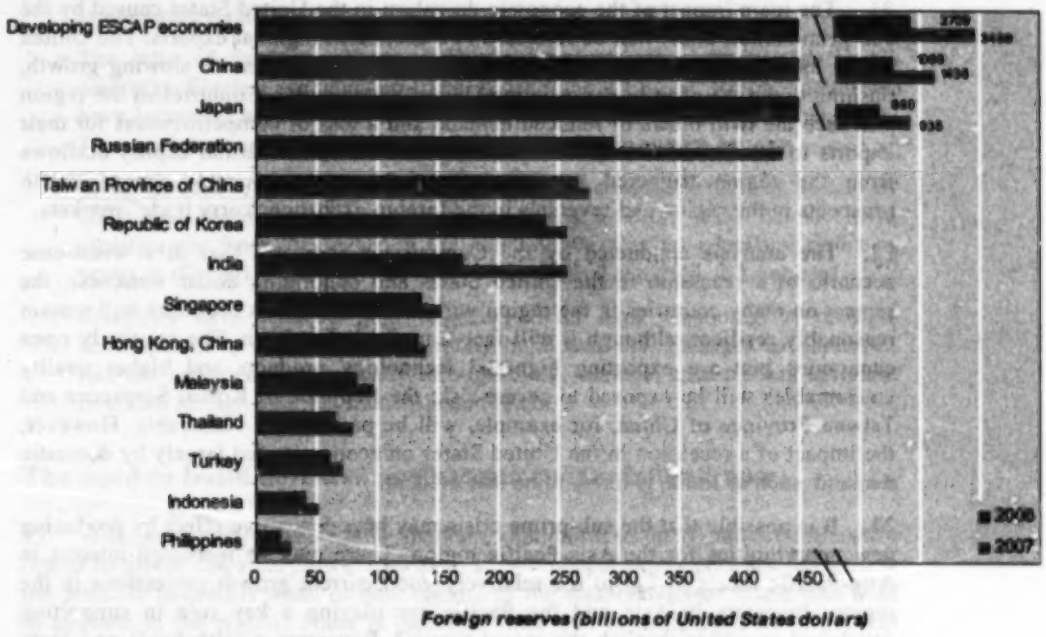
Source: Based on online data from Bank for International Settlements database, available from http://www.bis.org (accessed 17 January 2008).

[a] January 2006 = 100.

D. Reserves accumulate: at what cost?

17. By October 2007, developing economies in the Asia-Pacific region had accumulated $3.4 trillion in foreign reserves, up from $2.7 trillion at the end of 2006 (see figure IV). While reserves have been accumulated partly as a buffer against financial crises, the rapid increase has also been the result of a struggle to control the appreciation of regional currencies. Central banks have been conducting sterilization operations to mop up the excess liquidity created by the accumulation of reserves. Other measures have included increases in bank reserve ratios and interest rates. However, increases in money supply aggregates over recent months indicate that liquidity is continuing to grow.

Figure IV
Major holders of foreign reserves in the Asian and Pacific region, 2006-2007



Source: IMF, International Financial Statistics, CD-ROM (Washington, D.C., 2007).
Note: Foreign reserves exclude gold. Data for 2007 refer to October 2006 or the latest available month.

18. Increasing liquidity has fuelled concerns about inflation. In November 2007, China witnessed its highest inflation in 10 years, and India experienced a two-year high in January 2007 before aggressive tightening lowered prices. In addition to consumer price inflation, liquidity has driven up the prices of other assets, some of which are unrealistic in view of underlying valuations. The price-to-earnings ratio for equities in China is now 59 times 2007 earnings, by far the highest such ratio in Asia. In urban centres in India such as Bangalore and Mumbai housing prices doubled in 2005 and 2006. The Republic of Korea has also seen a substantial rise in property prices in some urban areas.

19. Currency appreciation means that Governments have incurred increased fiscal costs. Foreign exchange reserves have been invested mainly in low-yielding United States Government bonds. Another cost is the loss in the capital value of foreign reserve holdings as the value of the dollar steadily declines.

III. Downside risks to the 2008 outlook: navigating the sub-prime crisis

20. The major risk to the 2008 forecast lies in the spillover effect of the downturn in the United States housing market. Thus far, regional economies have been relatively immune to the tighter credit conditions unfolding in the United States and the member countries of the European Union. The corporate sector in the ESCAP

region is generally cash rich and not highly leveraged. The region is also reported to have had little exposure to holdings of sub-prime and other vulnerable debt.

21. The main impact of the economic downturn in the United States caused by the sub-prime credit crisis will be reflected in a decline in regional exports. The United States has been cutting interest rates aggressively in response to slowing growth, pushing down the already depreciating United States dollar. Countries in the region will face the twin blows of reduced demand and a loss of competitiveness for their exports to the United States. There is also the risk of substantial capital outflows from the region triggered by external developments, concerns about growth prospects in the region and reversals in the foreign exchange "carry trade" markets.

22. The analysis conducted by the Commission indicates that in a worst-case scenario of a recession in the United States and continuing dollar weakness, the impact on many countries in the region will be harsh. China's economy will remain reasonably resilient, although it will face a marked slowdown. The relatively open economies that are exporting high-end technology products and higher quality consumables will be exposed to severe risk: the Republic of Korea, Singapore and Taiwan Province of China, for example, will be particularly vulnerable. However, the impact of a recession in the United States on economies led largely by domestic demand, such as India, is likely to be less evident.

23. It is possible that the sub-prime crisis may have a positive effect by producing new opportunities for the Asia-Pacific region. There may be increased interest in Asia-Pacific assets, owing to the relatively good current growth projections in the region. Investors in Asia and the Pacific are playing a key role in supporting developed countries through the recent turmoil. Sovereign wealth funds and State investment institutions in the region have been major players in bolstering weakened banking sectors in the United States and Europe. The shifting balance of financial power to the region is also evident from the dramatic rise in overseas investments made by the Asia-Pacific corporate sector.

A. Asia and the Pacific well prepared to navigate global instability

24. Asian and Pacific countries and areas have made great progress in reviving their economies since the Asian financial crisis of 1997. As a result, the region is well equipped to navigate global financial and economic instability, as evidenced by the following:

- The region's GDP has doubled since 1997, with per capita incomes now significantly above their pre-crisis values.
- Countries have moved explicitly towards targeting inflation, rather than exchange rates. China and Malaysia widened their exchange rate bands in 2005, and there has been significant currency appreciation since that time. The Philippines, the Republic of Korea and Thailand also saw large appreciations. Removing explicit exchange rate targets reduces the risk of currency mismatches and encourages investors to hedge their currency exposure.
- Government budget deficits have gradually declined and, in some countries, have become surpluses. Concern about exploding public debt is thus limited, with public debt at its lowest level since 2000 in most countries.

- There have been no signs of excessive current account deficits, as there were in the prelude to the 1997 crisis. In fact, post-crisis East Asia is now an exporter of capital to the rest of the world. In 2007, current account surpluses in emerging Asian economies stood at 6.5 per cent of GDP.
- The ratio of foreign exchange reserves to short-term debt is high in all countries. Foreign exchange reserves in developing ESCAP member countries have increased sixfold since 1997, reaching $3.4 trillion as of October 2007. Those reserves can smooth any sudden interruption in capital inflows.
- There has been no excessive build-up of private domestic credit as a share of GDP, and the ratio of non-performing loans to total loans has declined significantly from the levels in the early 2000s. Capital adequacy ratios of banks in the region are well above the international standard of 8 per cent.
- Countries have reduced their dependence on bank financing. A positive development is nascent local currency bond markets. Changes in perceived risk are reflected automatically through those markets, causing less systemic risk than foreign currency-denominated loans.

B. The need to build defences against sub-prime fallout, now

25. With increasingly open capital markets, economies in the region are intimately linked to global financial flows. However, since investor sentiments are fickle, it is not possible to predict when or how turmoil in the financial sector might take hold in markets in the region. There is therefore little that countries can do to prevent external financial sector shocks. Even so, countries can ensure that their economies are strong and flexible enough to weather shocks and adapt to them. Efforts to mitigate the effects of financial shocks are critical because they exact a heavy toll on the poor, who are the least prepared to cope and who suffer the most from any income shock.

26. An effective defence against the effects of a financial crisis includes macroeconomic measures to build resilience to shocks and socio-economic measures to reduce the impact on the poor. In that regard, countries must ensure that they have the following:

(a) Solid macroeconomic fundamentals to maintain investor confidence and sustain economic growth. Key elements are moderate and stable inflation; sound fiscal policies that ensure low budget deficits and sustainable debt burdens; and more flexible exchange rate regimes that can absorb shocks;

(b) Healthy financial sectors to build confidence and benefit from capital inflows. Authorities must keep pace with the increasing diversity and complexity of the new financial products applied in regional markets. Financial markets need to be deepened by developing domestic and regional bond markets;

(c) Robust microeconomic foundations to ensure the efficiency of the economic system, a basic requirement of which is the establishment of clear property rights, overseen by a strong judiciary, allowing companies and institutions to operate effectively;

(d) Social safety nets to protect those facing hardships during economic downturns. Renewed and urgent action is needed now as such systems are difficult

to set up during times of crisis. An effective safety net should be targeted at the poor but should be large enough in scale and coverage to provide broad-based social protection to maintain an adequate standard of living;

(e) Improved regional cooperation, both to prevent crises and to enable countries to react in the event of crises. More needs to be done across the countries of the region to provide an effective early warning system for potentially disruptive flows.

IV. Long-term challenge to the region: addressing the neglect of agriculture

27. Despite good economic performance and the efforts of Governments to foster inclusive development, there are a number of emerging problems in the region. Over 600 million of the world's poor live in Asia, nearly two thirds of the global total. That population lives largely in rural areas and is dependent on agriculture. Addressing the apparent neglect of the agricultural sector should be a regional priority to ensure further progress in reducing poverty and inequality.

28. Agriculture provides employment for 60 per cent of the working population in the Asia and Pacific region. Four decades of neglect of agriculture has, however, weakened the sector's capacity to lower poverty and inequality. Growth and productivity in agriculture have been slowing, and the "green revolution" that boosted agricultural yields in the 1970s has bypassed millions. Pressure on farmers is mounting, as evidenced by declining subsidies, rising input prices, increasing protests over landlessness and an alarming number of suicides among those living in debt.

A. Agriculture: a powerful driver of poverty reduction and social equity

29. Increased economic growth is only one aspect of efforts to reduce poverty. The regions and sectors of growth are also important. Poverty in India can more easily be addressed through rural economic growth than urban economic growth. It must be kept in mind that differences in initial conditions related to rural development and human resources development lead to different outcomes, and that agricultural productivity and public expenditure on rural development are important determinants of poverty.

30. Agricultural labour productivity has a significant impact on poverty reduction. Estimates by the Commission show that a 1 per cent increase in agricultural productivity would lead to a 0.37 per cent drop in poverty in the Asia-Pacific region. Given the large agricultural labour productivity gaps among countries in the region, the potential gains appear to be substantial. According to the ESCAP analysis, raising the region's average agricultural productivity level to that of Thailand's, the

benchmark for the analysis, would lift 218 million people out of poverty.[1] India has the most to gain from a productivity drive, with nearly two thirds of the total poor in the region and a large agricultural productivity gap.

31. Investment, literacy and agricultural productivity reduce income inequality, and increases in agricultural value added are even more effective in reducing income inequality since they have a disproportionate impact on the lowest income groups. The Commission's estimates indicate that raising agricultural productivity levels to that of Thailand could reduce inequality by 6 per cent, as represented by the Gini coefficient.

32. Agricultural research and development, education of the rural population and reinforcement of rural infrastructure, including electricity and roads, are key determinants of labour productivity that have a major impact on poverty reduction. There is also strong evidence that agricultural productivity has a significant impact on human capital development.

B. Liberalization of agricultural trade and its impact on poor farmers

33. The liberalization of trade in agricultural products and its impact on developing economies has been a historically contentious issue in international trade negotiations, including the Doha Development Round. Developing countries have thus far been cautious in instituting multilateral agricultural trade reforms owing to the possible harm that might be caused to economies through preference erosion and rising agricultural prices for small food-importing economies, as well as the possible adverse effects on food security and poverty.

34. The Commission's analysis of the impact of agricultural trade liberalization under the Doha reforms reveals a reduction in poverty in some countries and an increase in others. In the Asia-Pacific region, in the short run, 5 million people living on less than one dollar a day could be lifted out of poverty through agricultural trade reforms under the Doha Round, with a possible increase to 7 million in the long run. In China, possible gains appear to be the most dramatic, with the number of poor people being reduced by as many as 10 million, mainly in rural areas, through an increase in the real wages of unskilled workers. In Thailand and Viet Nam, the prevalence of poverty would also be reduced, as well as in Indonesia and the Philippines. Poverty would increase, however, in Bangladesh, India, the Russian Federation and Sri Lanka in both the short and the long run. India would suffer the most, with 7.2 million additional poor, owing to the negative impact on the real wages of unskilled labourers.

35. If the countries go beyond the Doha reforms and undertake comprehensive agricultural liberalization, eliminating all tariffs, export subsidies and domestic support for agricultural and food products, 48 million people could be lifted out of poverty in the Asia-Pacific region over the short run, and possibly 51 million in the

[1] The agricultural labour productivity rate prevailing in Thailand was taken as the benchmark for several reasons: it is one of the few countries in the region that has achieved most of the Millennium Development Goals, and agriculture has contributed much towards the achievement of those targets. In addition, the productivity levels prevailing in better performing countries (such as Malaysia, the Republic of Korea and Singapore) are either relatively high or not representative.

long run. In all countries, except Sri Lanka, there would be a reduction in the level of poverty. In rural China nearly 25 million people could rise out of poverty, and in India 12 million.

36. Many other studies find that agricultural trade reform may have a positive impact on developing economies. In China, the urban-to-rural income ratio declines under global trade liberalization scenarios, although not significantly. The results also suggest that the largest increases in welfare would accrue to rural households. In Indonesia, the impact on inequality would be negligible, but rising incomes would boost a small number of people out of poverty.

C. Creating a socially and economically viable agricultural sector: a two-pronged approach

37. Since the majority of the poor live in rural areas and depend heavily on agriculture for their survival, it should be a regional policy priority to revitalize agriculture. Some of the poor will remain in the agricultural sector and will continue to make their primary livelihood from farming. Others, however, will move from that sector to industry or services, which offer better employment opportunities and a chance to escape from poverty. Policies should be put in place to make the transformation easy. Agriculture alone will not raise the 641 million poor people in the Asia-Pacific region out of poverty. Developing the non-farm sector is equally important. The survey proposes a two-pronged strategy to ensure that agriculture is both economically and socially viable, restoring its vital role as an engine for reducing poverty and inequality.

38. First, agriculture needs revitalization. That requires a market orientation with a focus on quality and standards. Investment needs to be made in research and development in order to improve agricultural productivity. In addition, investment must be made in health, education and technological innovation in this sector. Land policies, which connect the rural poor to cities and markets, must be revised, and credit instruments and crop insurance must be made readily available to those in farming communities.

39. Second, facilitating the movement of people from the agricultural sector should complement agricultural development, including by empowering the poor, particularly women, improving skills to tap labour market opportunities and promoting rural non-farm activities and regional growth centres. Public policy should support both tracks, thus levelling the playing field for poor and rich.